

Internal Revenue Service  
**memorandum**

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Br4:GBFleming

date: OCT 17 1988

to: District Counsel, San Jose W:SJ  
Attention: Steven J. Sibley

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

This responds to your memorandum of July 12, 1988, requesting technical advice concerning the windfall profit tax (WPT) examination of the above-referenced taxpayers for taxable years [REDACTED] through [REDACTED].

ISSUE

Whether the statute of limitations bars assessment of windfall profit tax from subsidiaries of [REDACTED] ("[REDACTED]") for taxable years [REDACTED] and [REDACTED].

FACTS 1/

In [REDACTED] [REDACTED] formed [REDACTED] ("[REDACTED]"), a wholly-owned subsidiary, which purchased certain producing properties from [REDACTED]. Similarly, in [REDACTED] [REDACTED] formed [REDACTED] ("[REDACTED]"), another wholly-owned subsidiary, which purchased certain other producing properties from [REDACTED]. For income tax purposes, these two subsidiaries were treated as part of [REDACTED]'s consolidated group for taxable years [REDACTED] and [REDACTED].

[REDACTED] and [REDACTED] sold the crude oil produced from their respective properties to [REDACTED], which was the operator of the properties. During [REDACTED] and [REDACTED], [REDACTED] withheld and deposited the WPT liabilities of [REDACTED] and [REDACTED]. In determining the amount withheld and deposited on behalf of these subsidiaries, [REDACTED] applied each subsidiary's estimated 90-percent net income limitation ("NIL").

[REDACTED] and [REDACTED] did not file either quarterly or annual Forms 720 for [REDACTED] and [REDACTED]. They did, however, file separate

1/ The factual presentation is based on the factual statement in your memorandum of July 12, 1988, and additional information obtained by telephone from [REDACTED], the Team Coordinator for the [REDACTED] examination team.

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Forms 6249, which were attached to [REDACTED]'s consolidated returns for those years. Notwithstanding [REDACTED]'s underwithholding, the subsidiaries' Forms 6249 showed overpayments of WPT as a result of applying each subsidiaries' actual NIL. Beginning with the first quarter of [REDACTED], [REDACTED] and [REDACTED] each filed integrated oil company certificates with [REDACTED] and made their own WPT deposits.

Separate extensions were obtained from [REDACTED] for each quarter for [REDACTED] through [REDACTED], limited to [REDACTED]'s WPT liabilities as a producer. No extensions were obtained from [REDACTED] and [REDACTED] with respect to their WPT liabilities for [REDACTED] and [REDACTED] on either a quarterly or annual basis. [REDACTED] has informally questioned whether the statute of limitations has expired on the subsidiaries' WPT liabilities for [REDACTED] and [REDACTED].

#### APPLICABLE LAW

I.R.C. § 4986 imposes a tax on the windfall profit from taxable crude oil removed from the premises during each calendar quarter. The tax is to be paid by the producer of the crude oil.

I.R.C. § 4995(a)(1) provides generally that the first purchaser of any domestic crude oil shall withhold a tax equal to the amount of the tax imposed by section 4986 with respect to the oil from amounts payable by the purchaser to the producer of the oil.

Under I.R.C. § 4995(a)(4), any amount of WPT withheld is treated as having been paid by the producer. The payment is deemed to be made on the last day of the first February after the calendar year in which the oil is removed from the premises.

Under I.R.C. § 4995(a)(5), except to the extent provided in regulations, a producer of crude oil with respect to which withholding is required shall not be required to file a return of the tax imposed by section 4986 with respect to that oil.

Treas. Reg. § 51.4995-1(a)(1) provides that the withholding requirements will not apply if (1) the crude oil is removed from the premises before sale, (2) the manufacture or conversion of the crude oil into refined products begins before the crude oil is removed from the premises, (3) the producer is an integrated oil company, or (4) the purchaser has received a qualified disburser's certificate.

Under Treas. Reg. § 51.4995-2(c)(2), every integrated oil company that is a producer of crude oil from a property of

which that company is the operator shall furnish to each purchaser of crude oil from that property a certificate stating that it is an integrated oil company and will deposit its own WPT liability. An integrated oil company that is a producer of crude oil from a property of which it is not the operator may, at its option, furnish such a certificate to the purchaser of crude oil from the property.

I.R.C. § 4995(b) provides separate deposit requirements for crude oil subject to withholding and not subject to withholding.

I.R.C. § 4995(b)(3) defines "integrated oil company" to mean a taxpayer described in paragraph (2) ["retailer"] or (4) ["refiner"] of section 613A(d) who is not an independent refiner. Pursuant to section 613A(d)(4) and Treas. Reg. 51.4996-1(g)(2), a "refiner" is a person who is engaged in the refining of crude oil or is related to a person so engaged, providing that the refinery runs of the person and any related person exceed 50,000 barrels on any day during the taxable period. Under section 613A(d)(3) the term "related person" includes a person owning 5 percent or more in value of the outstanding stock of a corporate taxpayer.

I.R.C. § 4996(a)(1) defines "producer" to mean the holder of the economic interest with respect to the crude oil.

I.R.C. § 4997 provides that each taxpayer liable for tax under section 4986 shall make such returns as the Secretary may by regulations prescribe.

Treas. Reg. § 51.4997-1(a)(2) provides that a return for each calendar year shall be made by each producer of crude oil whose liability for tax with respect to crude oil that was removed during the four taxable periods of the calendar year exceeds the amount of tax withheld with respect to that crude oil. Pursuant to section 6076(a) of the Code and section 51.6076-1 of the regulations, the annual return is required to be filed not later than May 31 of the year following the removal year.

Under I.R.C. § 6501(a), except as otherwise provided, the amount of any tax must be assessed within 3 years after the return is filed (whether or not such return is filed on or after the date prescribed).

I.R.C. § 6501(c)(3) provides that in the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

I.R.C. § 6501(c)(4) provides that before expiration of the time prescribed for assessment the Secretary and the taxpayer may consent in writing to extend the period for assessment.

I.R.C. § 6501(p) provides that in the case of any oil to which section 4995(a) applies and with respect to which no return is required, the return referred to in section 6501 is the producer's income tax return for the taxable year in which the removal year ends.

#### DISCUSSION

Section 4986 imposes the WPT on the producer of the crude oil. Although [REDACTED] has been designated as the operator of the properties from which the crude oil is produced, there is no dispute that the subsidiaries, [REDACTED] and [REDACTED], own the operating interests in those properties. Accordingly, the two subsidiaries are the producers and are charged with the WPT liability for the crude oil produced from their respective properties.

The question raised by your request is whether assessment of the subsidiaries' WPT liabilities for [REDACTED] and [REDACTED] is barred by the statute of limitations. Your memorandum proposes that the Service argue that the Forms 872 executed by [REDACTED] apply to extend the statute of limitations for the subsidiaries' WPT liabilities for [REDACTED] and [REDACTED]. This argument would be based on the fact that (1) neither subsidiary filed quarterly Forms 720 during [REDACTED] and [REDACTED] and (2) the subsidiaries' WPT liabilities were reported and deposited on the Forms 720 filed by [REDACTED]. Because the parent is considered to be the agent for the members of an affiliated group, it would be argued that [REDACTED] was reporting the WPT liabilities on the subsidiaries' behalf. Accordingly, the extensions executed by [REDACTED] would arguably apply to the subsidiaries under the holding in Landy Towel & Linen Service, Inc. v. Commissioner, 38 T.C. 296 (1962). For the reasons discussed below, we believe that there are some considerations that may make it difficult to prevail on this proposed argument.

First, certain additional facts that were not initially presented may permit [REDACTED] and the subsidiaries to avoid the agency analysis. Because [REDACTED] is both a retailer and a refiner under section 613A(d), it is an integrated oil company pursuant to section 4995(b)(3). As [REDACTED]'s subsidiaries, [REDACTED] and [REDACTED] are each integrated oil companies because they are related to a refiner within the meaning of section 613A(d)(3).

As integrated oil companies that are not the operators of their respective properties, [REDACTED] and [REDACTED] each had the option, pursuant to Treas. Reg. § 51.4995-2(c), of filing integrated oil company certificates with the first purchaser ([REDACTED]) and depositing their respective WPT liabilities directly as integrated oil companies. In fact, they eventually filed integrated oil company certificates in the first quarter of [REDACTED]. During [REDACTED] and [REDACTED], however, no such certificates were filed, and the oil produced from their properties was subject to withholding. Accordingly, in [REDACTED] and [REDACTED] it was proper for [REDACTED], as first purchaser, to withhold and deposit [REDACTED]'s and [REDACTED]'s WPT liabilities.

This conclusion is not changed by the fact that, in determining each subsidiary's WPT liability, [REDACTED] improperly applied the estimated net income limitation ("NIL") and thus did not withhold or deposit sufficient amounts for their WPT liabilities. 2/ Although [REDACTED] did not withhold the proper amounts, it can legitimately argue that it was withholding and depositing the subsidiaries' WPT liabilities as the first purchaser and not as the subsidiaries' agent.

We believe that [REDACTED]'s status as a first purchase would probably render the agency argument inapplicable in this case. In addition, we note that although the agency theory of Landy Towel & Linen Service, Inc., supra, would apply with respect to statute of limitations for the assessment of the subsidiaries' income taxes, it does not necessarily apply to excise taxes. For purposes of the excise tax, each member of a consolidated group generally files its own excise tax return. The concept of a consolidated group does not ordinarily apply to the excise tax liabilities of affiliated corporations. Cf. Informal Ruling No. 50 (August 10, 1932), [1932] Stand. Fed. Tax Serv. (CCH) 2333.

For these reasons, we believe that the agency theory would not provide a basis for assessing the subsidiaries' WPT liabilities in the absence of valid extension agreements. We believe, however, that there are other theories that may preserve the amounts of the proposed adjustments in the subsidiaries' WPT liabilities for [REDACTED] and [REDACTED]. We are

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2/ Theoretically, [REDACTED] is subject to the penalty on the underpayment of its deposits with respect to the WPT liabilities of [REDACTED] and [REDACTED]. I.R.C. § 6656(a). The statute of limitations has expired, however, for [REDACTED] and [REDACTED], and the Forms 872-A executed by [REDACTED] extended the statute only for purposes of [REDACTED]'s WPT liability as a producer, not as a purchaser.


continuing to analyze these alternative theories and will forward a supplementary memorandum setting forth our analysis and our suggested course of action.

Although the limitations issue raised by your request is a substantial question, we do not believe that it poses an insurmountable bar in this case. We recommend that the examination team be advised to proceed with the examination and to determine the amounts of all proposed adjustments to the subsidiaries' WPT liabilities.

We expect to complete our analysis of the alternative theories and forward a supplementary memorandum in the near future. In the interim, please contact Gerald Fleming at FTS 566-3345 if you have any questions on this matter.

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